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SIPDIS

TREASURY FOR INT'L AFFAIRS - CPLANTIER
NSC FOR MCKIBBEN

SENSITIVE

E.O. 12958: N/A
TAGS: EFIN PREL TU
SUBJECT: BOTH GOT AND MARKET PLAYERS SAY THEY'RE READY FOR EU-RELATED VOLATILITY

THIS CABLE HAS BEEN COORDINATED WITH CONGEN ISTANBUL.

1.(SBU) Summary: Neither private nor public sector financial market experts are worried about a severe market disruption if the foreseen October 3 start of Turkey's accession negotiations is derailed. To be prudent, however, the Turkish Treasury has built up cash reserves that cover its entire domestic borrowing requirement for October. Even in a bad scenario, Treasury believes it will be able to resume borrowing in a week or two. End Summary.

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Turkish Treasury and Central Bank Prepared for Worst-Case Scenario:
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2.(SBU) Although Turkey and the EU are widely expected to announce the start of Turkey's EU accession negotiations October 3, a last-minute snafu cannot be ruled out. In a negative EU scenario, financial markets are likely to be volatile, and a sharp sell-off would be likely. However, neither financial market contacts in Istanbul nor Turkish Treasury or Central Bank officials are worried about a severe disruption, let alone a crisis.

3.(SBU) Turkish Treasury domestic debt manager Volkan Taskin confirmed that the Treasury has prudently prepared for the worst by building up its cash reserves to about 14 Billion New Turkish Lira (YTL), equivalent to about $10.5 billion. He said this amount exceeds Treasury's October domestic borrowing requirement. With this large a cash position, even if the markets go into a tailspin, Treasury could get through the month without any new borrowings. Taskin (and virtually all observers) view this as an extreme scenario. He indicated that even if market conditions are very bad he would expect to resume domestic borrowings within a week or two.

4.(SBU) Likewise, neither the head of the Markets Department at the Central Bank nor the IMF Deputy Resrep were worried about the possibility of post-October 3 volatility. The IMF official noted that a market correction could even be healthy, given the continuing strengthening of the exchange rate and the danger arising from the market's long run of optimism. However, the IMF official was not worried that a derailed EU process would send markets into a tailspin.

¶5. (SBU) The Deputy Resrep said that the Central Bank's decision not to cut rates in September, a decision questioned by some economists as unjustified by the data, could be related to pre-October 3 caution on the Bank's part, particularly given uncertainty about how tight a fiscal policy the GOT will adhere to in 2006. The Central Bank official, who sits in on Monetary Policy Committee meetings, said the members may have been influenced by the EU accession process' link to expectations. (In general, the Central Bank insists it only targets inflation, and has often cited the need to focus now on meeting the 2006 target. The GOT and the IMF are currently in disagreement on the appropriate primary surplus target in 2006.) The Deputy Resrep was not concerned about post-October 3 volatility, and acknowledged that the Central Bank has built up more reserves than required under the program. However, from a longer-term vulnerability perspective, he pointed out that Turkey has a relatively low ratio of foreign exchange reserves to short-term debt in comparison with other emerging market countries.

Financial Market Contacts Not Worried:

6.(SBU) Bank economists and treasurers in Istanbul seem unworried about severe financial consequences arising from problems with the EU. Citigroup economist Olgay Buyukkayali, for example, told econoff much of the recent foreign investor appetite was due to improvement in Turkish fundamentals and opportunities in Turkey, rather than purely an EU accession play. Even in a worst-case scenario, Buyukkayali predicted a sharp sell-off but not a crisis. He doubted the lira would depreciate past 1.45 to the dollar. Also sanguine, Fitch Ratings Agency's Ayse Botan Berker did not expect Fitch to downgrade Turkey if the EU accession was somehow derailed. If, on the other hand, Turkey does receive accession-country status on October 3, Fitch will begin a review with an eye towards a possible upgrade in its sovereign rating. A Standard and Poors analyst made similar comments that were quoted in the press. Akbank Treasurer Resit Toygar noted Treasury's strong cash reserve position and said the domestic treasury market had become a "seller's market" of late, with Treasury having the upper hand with buyers. Treasury official Taskin's comments reinforced Toygar's view: Taskin said for the remainder of 2005 Treasury's domestic rollover rate will only be 80 percent.

¶7. (SBU) Comment: Both the authorities and financial market players seem ready for any unexpected market problems next week. Even in a negative scenario, a full-blown financial crisis seems unlikely.

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